

TITLE: Biennial Budget Development Update

DESCRIPTION: Staff provided an update on the 2024-2026 biennial budget development process. It will not be covered in detail during the June 9, 2023, board meeting.

PRESENTER: Eric Farris, Committee Chair

COMMITTEE'S REVIEW

The Finance Committee received this information report at its June 6, 2023, meeting. It will not be covered or presented in detail at the June 9 board meeting; however, staff will be available for questions.

SUPPORTING INFORMATION

The Council on Postsecondary Education is directed in statute to make a biennial budget request for postsecondary education (HB 1, 97 RS). Major components of the request typically include: (1) operating funds; (2) capital investment; (3) trust funds; and (4) agency operations. Developing a unified budget request is a collaborative process, involving Council members, campus presidents, chief budget officers, and CPE staff. It normally takes nine months to complete the process and ends with Council approval of the request and its submission to the Governor and General Assembly.

For the upcoming 2024-2026 biennium, the deadline for submitting the postsecondary education budget request to the Office of State Budget Director has been moved up from November 15, 2023 to on or before October 1, 2023 (HB 360, 23 RS). This has accelerated the timeline for discussion of budget components and request amounts and necessitates reaching consensus six weeks earlier than in past biennia. To date, CPE staff has engaged in discussions with campus presidents and chief budget officers over several meetings to identify high priority resource needs.

It is important for Council members to know that the information contained in this update is preliminary and subject to change. CPE staff does not yet have full consensus among campus leaders regarding these funding components and request amounts, nor have Council members provided their input. At this point, please treat this information as draft for discussion purposes only.

POSTSECONDARY INSTITUTION REQUEST

The Council's biennial budget recommendation for the public postsecondary institutions typically contains three categories of funding: (1) operating funds; (2) capital investment; and (3) trust funds. Within the context of stakeholder discussions to date, preliminary funding components and request amounts for each category are described below.

Operating Funds

At this stage in the process, operating funds components most frequently discussed among staff and campus leaders include: (1) an across-the-board inflation adjustment request; (2) an earned performance funds component; and (3) an additional appropriation for the Postsecondary Education Performance Fund. Again, please keep in mind that the budget components and request amounts included in this update are still being negotiated and are not final.

Inflation Adjustment. Stakeholders are contemplating a request for additional operating funds of \$54.7 million each year of the 2024-2026 biennium, recurring in subsequent years, at the discretion of state policymakers. This amount represents the combined total of a 6.0% across-the-board increase applied to each institution's fiscal 2023-24 net General Fund base, and the funds would be allocated among institutions on that basis.

If recommended by the Council and authorized by the General Assembly, these funds would help institutions offset some of the largest increases in higher education inflation in decades. For example, in 2021-22, the Higher Education Price Index grew by 5.2%, representing the largest one-year increase in that index since 2001. In addition, the funds would help the Council and campus officials maintain affordability and access for Kentucky citizens and provide resources necessary for institutions to continue making progress toward the state's student success goals. This request would be an increase of 5.4% on the 2023-24 system total net General Fund base (includes Performance Fund).

Earned Performance Funds. CPE staff and campus officials are considering a request for additional appropriations of \$48.7 million each year of the biennium, recurring in subsequent years, at the discretion of the state policymakers. This amount is half of \$97.3 million appropriated to the Postsecondary Education Performance Fund in fiscal year 2023-24 and distributed among institutions using university and KCTCS funding models prescribed in statute (KRS 164.092). As currently conceived, the Council would recommend to state policymakers an appropriation equal to half (50%) of the funds earned by each institution that received a performance distribution in 2023-24.

If requested by the Council and authorized by the General Assembly, these funds would help defray operating costs at institutions that grew enrollment, student progression, degree production, and earned credit hours at rates above the sector average (i.e., at institutions that received performance funds) and move all institutions toward funding parity as determined by

the funding models. This request would be an increase of 4.8% on the 2023-24 system total net General Fund base.

Performance Fund. Stakeholders have discussed the possibility of including a request for additional appropriations of \$22.7 million each year of the biennium that would be added to \$97.3 million already in the Postsecondary Education Performance Fund, bringing the total in that fund to \$120.0 million. If recommended and authorized, these funds would provide resources necessary for institutions to continue making progress toward the state's student success goals and would help Council and campus officials maintain affordability and access for Kentucky citizens.

Capital Investment

Prior to 2020, the Council's capital investment request typically included three budget components: (1) new construction; (2) asset preservation; and at times (2) information technology and equipment. In recent biennia, stakeholders have elected to focus on asset preservation in the Council's budget recommendation, forgoing requests for new construction and technology and equipment funding.

For the upcoming biennium, discussions to date have centered around requests for asset preservation and a new component that would address cost overruns on new construction projects (i.e., scope adjustments) authorized in the 2022-2024 biennium.

New Construction. At this time, CPE staff and campus leaders are not contemplating including a request to support new construction projects in the Council's 2024-2026 budget recommendation. However, institutions are free to propose funding for new projects directly to the Governor and General Assembly and advocate for their own requests for new and expanded space.

Scope Adjustments. The enacted 2022-2024 Budget of the Commonwealth authorized \$811.9 million in state bond funds to finance 11 new capital construction projects at the public postsecondary institutions (HB 1, 22 RS), but a lot has changed in the time since institutions estimated costs, determined the scope of proposed projects, and submitted funding requests to the General Assembly. As previously mentioned, inflation reached a high in 2021-22 not seen in two decades. Construction costs were particularly hard hit, not only due to inflation, but also due to supply chain disruptions and worker shortages.

In a recent poll conducted by CPE staff, campus officials indicated that construction costs had increased between 18 percent and 25 percent over the past 18 months. For this reason, stakeholders have discussed the possibility of including a request in the Council's 2024-2026 budget submission for \$162.4 million, or a 20 percent increase in the amount of bond funds authorized for individual new construction projects in the 2022-2024 biennium. Obviously, the purpose of such a request would be to help offset increases in construction costs and allow

institutions to maintain the same quality of materials and quantity of square footage envisioned in their original capital plans.

Asset Preservation. Prior to the 2022-2024 biennium, the need to address facilities renovation and renewal at Kentucky public postsecondary institutions had not been addressed in any substantive way for more than a decade. Despite analyses showing that the cumulative cost of bringing the state's public postsecondary facilities up to industry standards would grow to \$7.3 billion by 2021 (VFA Study, 2013 update), state appropriations for asset preservation totaled \$282.0 million between 2008 and 2022.

For the upcoming 2024-2026 biennium, CPE staff and campus officials are considering recommending to the Council a request for \$700 million in state bond funds (or some portion of that amount could be cash funded) to finance renovation and renewal projects at the public postsecondary institutions. If the requested funds were authorized, it would be the second installment of \$700 million provided in as many biennia to address the identified \$7.3 billion system total asset preservation need.

Other ideas regarding this request surfaced during recent discussions between staff and campus chief budget officers. Namely, that stakeholders should consider requesting \$350 million each year of the biennium (instead of a \$700 million request in one year), allocated based on each institution's share of total Category I and Category II square feet (i.e., the method employed by the General Assembly in the current biennium), and that the funds be requested without any required institutional match.

Information Technology and Equipment. At this point in the process, stakeholders have not advocated to include a request for information technology and equipment in the Council's 2024-2026 budget recommendation. CPE staff and campus officials perceive other capital investment components to be higher priorities than information technology and equipment projects.

Trust Funds

The Kentucky Postsecondary Education Improvement Act of 1997 (HB 1) created six Strategic Investment and Incentive Trust Funds to bring about change and improvement in Kentucky colleges and universities by providing strategic financial incentives for institutions to pursue desired state goals for postsecondary education. These trust funds are listed below.

- 1) Research Challenge Trust Fund (UK and UofL)
- 2) Comprehensive University Excellence Trust Fund (comprehensive universities)
- 3) Technology Initiative Trust Fund
- 4) Physical Facilities Trust Fund
- 5) Postsecondary Education Workforce Development Trust Fund (KCTCS)
- 6) Student Financial Aid and Advancement Trust Fund

When the General Assembly authorizes appropriations for trust fund programs, they are typically maintained and administered by the Council on Postsecondary Education but represent resources that are passed through to postsecondary institutions based on compliance with Council approved guidelines and procedures.

Every two years, CPE staff works collaboratively with campus presidents, chief budget officers, and Council members to identify programs and recommend funding that will provide incentives for Kentucky colleges and universities to pursue and achieve state goals for postsecondary education. At this time, stakeholders are not requesting additional appropriations for any trust fund program for the 2024-2026 biennium.

CPE AGENCY BUDGET REQUEST

The fourth and final component of the unified budget request for postsecondary education is the Council's agency operations request. The agency's budget request typically includes base funding (current funding and staffing levels), additional resources needed to support current operations, and funding for new strategic initiatives.

The agency budget also includes a number of pass-through programs and funding that benefits institutions directly, such as the Kentucky Postsecondary Education Network (KPEN), Virtual Library, SREB Doctoral Scholars program, equine program, and cancer research programs. In recent years, private and federal funds in the agency budget have allowed CPE to expand its work improving the P-20 pipeline, promoting student success, and responding to the state's healthcare workforce needs.

Staff recently began meeting with leadership team members to identify the agency's most pressing resource needs, as well as high priority needs of the postsecondary system that can best be addressed with additional resources housed at CPE.

It is anticipated that following the end of the fiscal year (i.e., June 30, 2023), staff will have additional information relevant to the budget development process, including instructions from the Office of State Budget Director. In the meantime, staff will continue to identify and prioritize agency and postsecondary system resource needs for the 2024-2026 budget request.